PENNYMAC

PENNYMAC POLICY PULSE

OCTOBER 2025

GSE REFORM EFFORTS: WHERE ARE WE NOW?

The future of Fannie Mae and Freddie Mac has been a part of nearly every discussion we have had over the past year. Some have suggested that the Trump administration will prioritize ending the conservatorships as that is the last unfinished business from the global financial crisis. Others have argued that monetizing a portion of the government's stake in the companies will trump release from conservatorship. From our seat, it is wholly unclear what will happen next, but our sense is that the potential for structural action at the GSEs is more elevated now than at any point since the conservatorships began in 2008.

In our inaugural newsletter, we offer:

- Pennymac's administrative reform priorities;
- An outline of key questions and considerations; and
- Thoughts on the road ahead.

Pennymac's Administrative GSE Reform Priorities

Pennymac's overarching GSE reform policy goals are twofold:

- Maintain liquidity and stability in the housing market by preserving the GSEs' core functions; and
- Expand responsible access to credit in order to make homeownership more affordable and attainable.

In support of those two goals, Pennymac's top administrative GSE reform priorities are:

- **Do No Harm.** The housing market represents ~18% of GDP and policymakers should remain cognizant of the vital role the GSEs play in the mortgage ecosystem. We are broadly supportive of efforts to reconsider the conservatorships after 17 years, but our hope is that any transition is done in a thoughtful and deliberate manner.
- **Defined Guarantee.** The market requires clarity on the form and amount of the government's guarantee. Our preference would be for an explicit guarantee, but Congress appears highly unlikely to act in the near-term. Therefore, we believe policymakers should ensure that the existing PSPA lines are retained in any administrative reform scenario.
- **Maintain and Enforce Brightline Business Limitations.** The GSEs are vital cogs in the secondary market and they should remain focused exclusively on the secondary market. We strongly support brightline restrictions prohibiting the GSEs from entering certain businesses or undertaking certain activities.
- **Ensure FHFA Has the Authorities It Needs.** The FHFA has existed almost exclusively during the GSE conservatorships, which underscores our belief that policymakers should ensure that the FHFA has all of the tools and resources necessary to fulfill its mission in a post-conservatorship world.

Foundational Questions and Known Unknowns

In 2002, Secretary of Defense Donald Rumsfeld introduced a framework for categorizing uncertainty. He described four types of knowledge:

- **Known knowns:** things we know we know
- **Known unknowns:** things we know we don't know
- **Unknown unknowns:** things we don't know we don't know
- **Unknown knowns:** things we don't realize we know

This framework is useful for analyzing complex policy challenges that involve uncertainty, conflicting incentives, and hidden assumptions. The effort to resolve the conservatorships of Fannie Mae and Freddie Mac fits that description. The corresponding graphic applies Rumsfeld's taxonomy to the future of the GSEs. It broadly outlines what policymakers and stakeholders think they understand, admit they don't, purposefully overlook, or unconsciously embed in their thinking.

GSE Conservatorship Rumsfeld Matrix

KNOWN-KNOWNS

- Policymakers are cognizant that the GSEs play a vital role in the housing ecosystem and they are reticent to take any action that would introduce operational or economic volatility
- The Trump administration is interested in taking action on the GSEs, even if the exact form is unclear at this juncture.
- The GSEs in aggregate have $166B in capital on their balance sheets, which makes taking structural action far easier than it was in the first Trump administration.

UNKNOWN-KNOWNS

- There is an inherent irony in pursuing "privatization" for the GSEs given their public mission, the varying forms of the government's guarantee, and the myriad mandates.
- The FHFA has relied heavily on its conservatorship authority, which leaves questions about past initiatives and future capacity.

KNOWN-UNKNOWNS

- Will the Treasury Department forgive or convert its $357B in senior preferred?
- Will the PSPA backstop operationally/legally convey in a post-conservatorship scenario?
- Will the limited explicit backstop be sufficient for MBS investors?
- Is there sufficient institutional investor demand for companies with high single-digit ROEs?
- Will the FHFA materially alter the GSE capital rule?
- How would the CSP work in a post-conservatorship world? Would the UMBS still be viable?
- Does the FHFA need any additional authorities in a post-conservatorship world?
- Can regulators find consensus on the capital treatment for MBS?

UNKNOWN-UNKNOWNS

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Source: Pennymac

Operational Work Should Continue While A Structural Plan Is Advanced

Policymakers continue to wrestle with the future of the government-sponsored enterprises. Should they exit conservatorship? What role should they play in housing finance? How do we balance access, risk, and taxpayer protection? These are weighty questions, and they deserve thoughtful answers. But while the long-term debate unfolds, the GSEs remain central to the mortgage market today. That means reform is not an all-or-nothing proposition. There is important work to be done right now to improve how the GSEs operate and execute.

From reviving credit risk transfer (CRT) to improving the GSE capital rules, there are practical steps that can strengthen the system regardless of where the broader policy conversation lands. Structural reform may take years. Operational progress should not. From our perspective, areas ripe for attention include:

- **Durable Capital Framework That Recognizes the Value of CRT.** The capital framework for the GSES, the Enterprise Risk Capital Framework (ERCF) is far from perfect, but we recommend targeted tweaks rather than structural shifts. Within this vein, we firmly believe that the ERCF should be calibrated to recognize the value of CRT. GSE CRT programs are critical to reducing taxpayer exposure by shifting a meaningful portion of mortgage credit risk from Fannie Mae and Freddie Mac to private investors. By offloading risk, the GSEs can optimize capital usage, improve ROE, and enhance balance sheet resiliency under the ERCF. In particular, lender risk-share deepens market liquidity, fosters private-sector discipline in pricing mortgage risk, and strengthens the broader housing finance system. We believe responsibly improving the ERCF should be on policymakers' agenda, no matter the status of GSE reform efforts.
- **Make Affordable Sensible.** While well-intentioned, the GSE single-family housing goals as structured can materially distort market pricing. This dynamic shifts loan volume between GSEs and FHA rather than expanding access to affordable housing, often resulting in adverse selection and non-economic behaviors in the secondary market. Ultimately, the current goal construct may undermine risk-based pricing and program integrity without increasing overall affordability. We believe there is a strong policy case for a simple fee on all GSE MBS issued.
- **Rightsize the Cash Windows.** The GSE cash windows serve the GSE missions by providing small lenders without securitization infrastructure access to the secondary market, and we are supportive of that mission. In recent years, however, the volumes running through the cash windows have exploded, largely due to pricing arbitrage, diligence differences, or some combination thereof. Overreliance on the cash windows undermines UMBS uniformity, increases taxpayer exposure, and serves as a clear example of mission drift.base

Destination Unknown, but Stated Guardrails Give Comfort

It is wholly unclear what path the president will choose. The full panoply of options appear to be on the table, from nothing happening to the conservatorships ending. We can envision a quick sale of a stake, likely to a non-economic actor given lingering questions about structure and returns. We can also see longer-term interests prevailing with a comprehensive plan to end the conservatorship over time.

Given the uncertainty at this juncture, we find it noteworthy that Trump administration officials have repeatedly stated that they will not act on the GSEs if doing so would harm the mortgage market. In May, Treasury Secretary Bessent said: "What I can tell you is that we are doing a great deal of studying at Treasury, because the one requirement for this privatization is that they are privatized in such a way that mortgage spreads do not widen." That same month, FHFA Director Pulte said: "We're going to make sure the mortgage market continues to function properly. That's our job." This stated commitment to market stability is reassuring and revealing. It suggests that the Trump administration will prioritize operational clarity, steer clear of sudden shifts, and act deliberately.

The destination remains unclear, but the contours of the map are beginning to emerge, defined more by boundaries than by precise pathways.

WHAT COULD COME FROM A NATIONAL HOUSING EMERGENCY?

Over Labor Day, Treasury Secretary Bessent said: "We're trying to figure out what we can do, and we don't want to step into the business of states, counties, and municipal governments. We may declare a national housing emergency in the fall." It is unclear whether a housing emergency is imminent, but at a minimum we continue to expect a housing supply executive order (EO) later this year. We offer a handful of initial thoughts on the potential implications below:

- **Zoning Reform.** We could envision an EO requiring the CEA/NEC to develop and advance a series of model state and local codes that promote housing supply. There could be tension over how prescriptive to be on this front given ideological dynamics, but zoning reform will almost certainly be a part of serious housing supply conversation.
- **Use Federal Land.** We expect any action to include a call to use federal land for housing development, but we urge caution on this front as 90% of federal land is west of the Mississippi and most federal land is in low-demand areas.

- **Manufactured Housing.** We continue to hear support for manufactured housing as we make our rounds with policymakers and peers. HUD has a number of levers it can pull on this front, and we know there is an appetite among some GSE leaders to be more active in this market segment.
- **Tariff Tweaks.** One of the easiest lifts for the Trump administration would be softening tariffs on imported building materials (e.g., lumber, gypsum).
- **What About the GSEs?** The FHFA as conservator already has immense control over the GSEs, and Director Pulte serves at the pleasure of the president, so the White House does not need a national emergency to advance its GSE agenda. With that being said, we could see any "national emergency" announcement including a list of policy shifts from the FHFA. To this end, we continue to hear chatter that the FHFA is inclined to reduce GSE LLPAs on purchase loans across the board. We also believe the GSEs could use their retained portfolios to purchase securities in order to narrow spreads, although that does carry some historical baggage.

QUICK HITS

Trump Calls From An End to Quarterly Earnings Reports, and This Time Could Be Different.

On September 15, President Trump renewed his call to shift from quarterly earnings releases to a semi-annual cadence. We understand the skepticism around this as Trump made a similar call in his first term, but our sense is that this time could be different given the combination of industry pressure and an aligned SEC Chair. On the industry pressure side, note that the Long Term Stock Exchange (LTSE) is leading a push on this front. As for the SEC, Chairman Atkins is a loyal soldier and our channel checks suggest this issue will move up on his agenda. Any effort to shift the reporting cadence will take at least 9 months due to rulemaking requirements. With that being said, there is a viable chance that the SEC switches the reporting to a semi-annual reporting cadence. In this scenario, we could envision some companies continuing to provide quarterly updates as we have seen in the UK and EU.

FHFA Proposes New Housing Goals.

On October 2, the FHFA proposed revised housing goals for the Enterprises for 2026 through 2028 along with replacing the two area-based subgoals with one low-income area subgoal, a simplified goal determination process, and other technical changes. The setting of such goals is a statutory requirement under the Safety and Soundness Act and is intended to be one measure of the extent to which the Enterprises are meeting their public purpose. Notable changes include:

- The Low-Income and Very Low-Income purchase goals were reduced to 21% and 3.5%, respectively. This is from current levels of 25% and 6%.
- Minority Census Tract Subgoal and Low-Income Census Tracts Home Purchase Subgoal have been eliminated and replaced with the Low-Income Areas Home Purchase Subgoal.

Basel 3 Endgame Proposal As Soon As This Year.

On September 25, Federal Reserve Vice Chair for Supervision Michelle Bowman said that regulators could re-propose the Basel 3 Endgame (B3E) capital framework as soon as later this year. That timeline is faster than many expected, and signals momentum behind finalizing the rule. Our expectation remains that the final rule will adopt a single-stack approach for large banks, cap operational risk, remove gold-plated risk weights, and refine the trading book framework. There are a number of pertinent mortgage banking issues of consequence, ranging from high-LTV risk-weights to the treatment of mortgage servicing assets. We also believe there is a strong policy case to reduce the risk weight for warehouse lines to reflect the underlying financial collateral. This is a vital issue for independent mortgage banks (IMBs), which originate over 60% of single-family mortgages and nearly 90% of all FHA/VA loans. This rulemaking provides an opportunity to address this issue, which would be positive for the first-time and low-to-moderate-income homeowners who rely on these government-backed loans.

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